



THE CITY OF SAN DIEGO

## Report to the City Council

DATE ISSUED: January 23, 2017 REPORT NO: 17-011  
ATTENTION: Budget & Government Efficiency Committee  
SUBJECT: Revision to the City of San Diego Reserve Policy  
REFERENCE: City Council Reserve Policy – Revised April 28, 2016

**REQUESTED ACTION:** Amend Council Policy #100-20 entitled “Reserve Policy” as follows: 1) reduce the Workers’ Compensation Reserve policy goal from 25% to 12%; and 2) change the funding schedule for the General Fund Stability Reserve from 0.5% a year to 0.25% while maintaining the policy goal of 16.7% for the General Fund Reserve.

**STAFF RECOMMENDATION:** Approve the requested item.

### SUMMARY:

The City’s Reserve Policy was adopted by Council in 2007 to establish essential reserves to strengthen the City’s financial position and address unexpected emergencies or unanticipated liabilities. The Reserve Policy has been revised several times, in Fiscal Years 2012, 2014, 2015 and 2016, to meet changing conditions of the City while maintaining appropriate reserves in the General Fund and the City’s enterprise funds. The General Fund reserves protect the General Fund from unpredictable increases in expenditures or reductions in revenues. Council Policy #100-20, the “Reserve Policy”, documents the City’s commitment to maintain strong reserves across all City operations.

City’s fiscal recovery and rating upgrades since 2007 have been due in large part to the City establishing a strong reserve policy, and more importantly, consistently funding reserves to reach policy goal amounts. Over the past 10 years, rating agencies have commented on the City’s fiscal strengths. In 2016, Moody’s affirmed the City’s Aa2 rating and stated that it expects “the city will continue to operate with strong fiscal discipline and reserves.”

Mindful of the importance of maintaining cash reserves to continue strengthening the City’s fiscal position and meet the policy objectives in the current Reserve Policy, this action recommends revisions to the Reserve Policy for the Workers’ Compensation Reserve and the General Fund Reserve. The purpose of the revisions are to right size the Workers’ Compensation Reserve and modify the funding targets for the General Fund Stability Reserve from 0.5% annually to 0.25%, while maintaining the policy goal of 16.7% for the General Fund.

### Revision to the Workers’ Compensation Reserve Funding Goal

Staff recommends that the Workers’ Compensation Reserve policy target be reduced from 25% of the most recent three year average of annual actuarial liability valuations to 12%, which is equivalent to approximately one year of operating expenses for the workers compensation program. Staff has continued to monitor reserve levels for the appropriate level of funding

and determined that the current level of Workers' Compensation reserve funding is larger than necessary to support claims payment experience.

The Workers' Compensation reserve has not been accessed since its inception in 2007. Most significantly, the claims payment stream, while steadily increasing annually primarily due to increased claims cost, is not volatile like payments experienced in the Public Liability program. In 2014, the City revised the Reserve Policy for Workers' Compensation to reduce the funding level to 25% from 50%, and this current proposed revision continues the right-sizing to provide sufficient reserves while deploying available cash more effectively to fund other General Fund reserves to policy levels.

In 2014, the City's staff report that accompanied the Reverse Policy revision stated the case for reducing the Workers' Compensation Reserve:

*Workers' compensation liabilities accrue and are paid out very differently than other City liabilities. The revised policy to reserve for workers' compensation liabilities recognizes the long term nature of the liability, in contrast to the immediate requirements for large payments in Public Liability, which involves larger claims and therefore larger reserves.*

*In civil claims litigation the value of the claim can be determined by either mutual agreement between the parties, by a jury, or by a judge. Once the total value has been determined, the City pays out the total value of the claim at one time, which draws from the Public Liability reserve. In contrast, all workers' compensation settlements are overseen by the State's Workers' Compensation Appeals Board (WCAB). Upon the WCAB's satisfaction that the level of disability has been appropriately determined, compensation for the disability is not paid out fully at one time with one payment; rather, it is paid out bi-weekly over a period of up to 13 years for cases of partial disability and over a lifetime for cases of total disability, with associated medical expenses paid as they are incurred. There is therefore low risk that the Workers' Compensation fund would be subject to large payouts at any one time as occurs with the Public Liability fund.*

*Recognizing the long term nature of workers' compensation claim development and payments, the City's ongoing commitment to fiscal discipline and the need to maintain healthy reserves, the proposed changes to the workers' compensation reserve policy is fiscally prudent. The Workers' Compensation Reserve will be reviewed every other year to ensure that it meets the target based on the average outstanding liability of the three most recent years and if needed, adjusted accordingly.*

The in depth review conducted by the Risk Management Department has determined that approximately one year of operating expenses, or 12% of the average three year liability is an appropriate reserve for the program.

#### Revision to the General Fund Reserve Funding Timeline

The City's General Fund Reserve is comprised of the Emergency Reserve of 8% and the Stability Reserve of 8.7%. In 2016, the funding goal for the Stability Reserve was increased to 8.7% from 6% with a schedule of annual percentage targets to be met through additional funding, detailed in the following table, until a total General Fund reserve of 16.7% was achieved.

**Current General Fund Reserve Target Contributions**

<i>TargetDate</i>	<i>Target Contribution (In Millions)</i>	<i>Projected Reserve Balance (In Millions)</i>	<i>Total General Fund Reserve Target%<sup>1</sup></i>
June 30, 2017	\$9.0	\$173.8	14.75%
June 30, 2018	\$9.3	\$183.1	15.25%
June 30, 2019	\$12.9	\$196.0	15.75%
June 30, 2020	\$11.8	\$207.8	16.25%
June 30, 2021	\$12.9	\$220.7	16.7%

1. Based on a rolling three-year average of projected annual General Fund operating revenues projected in the FY 2018-2022 Five-Year Financial Outlook.

Staff does not recommend revising the funding goal of a 16.7% General Fund reserve level (based on a three year average of operating revenue). This policy goal was approved in 2016 when the Reserve Policy was last updated and conforms to the Government Finance Officers Association (GFOA) best practices.<sup>1</sup> Staff recommends that the percentage funded each year to reach 16.7% be changed from 0.5% to 0.25% annually to smooth the payments, beginning in FY 2018. This means that the City will be expected to achieve the 16.7% policy goal in fiscal year 2025; four years longer than the prior projection.

**Recommended General Fund Reserve Target Contributions**

<i>TargetDate</i>	<i>Target Contribution (In Millions)</i>	<i>Projected Reserve Balance (In Millions)</i>	<i>Total General Fund Reserve Target%<sup>1</sup></i>
June 30, 2017	\$9.0	\$173.8	14.75%
June 30, 2018	\$6.3	\$180.1	15.00%
June 30, 2019	\$9.7	\$189.8	15.25%
June 30, 2020	\$8.4	\$198.2	15.50%
June 30, 2021	\$9.9	\$208.1	15.75%
June 30, 2022	\$10.7	\$218.8	16.00%
June 30, 2023	\$10.8	\$229.6	16.25%
June 30, 2024	\$10.9	\$240.5	16.50%
June 30, 2025	\$10.3	\$250.8	16.70%

1. Based on a rolling three-year average of projected annual General Fund operating revenues projected in the FY 2018-2022 Five-Year Financial Outlook. FY 2023-2025 assumes an average growth of 3% in operating revenues.

No additional changes are recommended to the City’s Reserve Policy.

CITY STRATEGIC PLAN GOAL(S)/OBJECTIVE(S):

Goal #1: Provide high quality public service

Objective 1: Promote a customer-focused culture that prizes accessible, consistent, and predictable delivery of services

Goal # 3: Create and Sustain a Resilient and Economically Prosperous City

FISCAL CONSIDERATIONS:

The current cash balance in the Workers' Compensation Reserve is \$56.5 million, slightly under the current reserve target of \$58.7 million. If the recommended policy change to a 12% Workers' Compensation Reserve is approved, the revised target balance would be \$28 million for Fiscal Year 2017.

If the recommendation to extend the timeline for achieving the 16.7% target funding level for the General Fund Reserve is approved, the Fiscal Year 2018 contribution would be \$3.0 million less than previously projected, leaving a \$6.3M funding requirement for FY 2018.

Recommendation on the use of excess reserve balances or any funds available from these policy changes will be incorporated into the Fiscal Year 2018 Proposed Budget. At that time we will consider the use of the one-time cash made available from the Workers Compensation Reserve revision to fund other General Fund reserves to meet policy targets, and other actions to reduce expense in the General Fund to produce a balanced budget.

EQUAL OPPORTUNITY CONTRACTING INFORMATION (if applicable):

N/A

PREVIOUS COUNCIL and/or COMMITTEE ACTIONS: Council approved the Reserve Policy as Ordinance No. O-19679 on November 20, 2007. The most current revision was approved by City Council on April 28, 2016 (Resolution No. R-310360).

COMMUNITY PARTICIPATION AND OUTREACH EFFORTS:

None.

KEY STAKEHOLDERS AND PROJECTED IMPACTS:

None.

*Signature on file* \_\_\_\_\_

Originating Department

*Signature on file* \_\_\_\_\_

Deputy Chief/Chief Operating Officer

- Attachment(s):
1. Revised Council Policy #100-20, Clean
  2. Revised Council Policy #100-20, Redline

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<sup>1</sup> GFOA recommends that governments maintain an unrestricted fund balance of no less than two months of general fund operating revenue or expenditures. City averages the most recent three years of operating revenue to determine funding targets.